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IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

PLUMBERS & STEAMFITTERS LOCAL 490 SEVERANCE AND RETIREMENT FUND; THE INDIVIDUAL PARTICIPANTS IN THE PLUMBERS & STEAMFITTERS LOCAL 490 SEVERANCE AND RETIREMENT FUND,
Petitioners,

vs.

WILLIAM APPLETON, TRUSTEE FOR THE LIQUIDATION OF FIRST OHIO SECURITIES COMPANY; AND SECURITIES INVESTOR PROTECTION CORPORATION,
Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED FOR REVIEW

First Ohio Securities Co. ("FOSC" or "the Debtor"), a securities brokerage firm, was placed in liquidation under the Securities Investor Protection Act, 15 U.S.C. §78aaa et seq. ("SIPA").* A trustee ("Trustee") was appointed for the firm who, consistent with SIPA, provided notice of the proceeding and claims materials to customers and other creditors of FOSC. Among the claims that were filed with the Trustee were those of Petitioners Plumbers & Steamfitters Local 490 Severance and Retirement Fund ("490 Fund" or the "Fund"), and its beneficiaries, the Individual Participants. Each sought, as a "customer" under SIPA, the return of cash and securities. The Trustee denied the claims of the Individual Participants on the ground that the Participants were not "customers." The claim of the 490 Fund was allowed. However, because the certificates of deposit ("CDs") which it sought were non-existent, the claim was treated, in its entirety, as one for cash. The cash portion of a customer claim is protected up to $100,000 under SIPA, and the Fund received that amount. But because the securities portion of a claim is protected up to $500,000 under SIPA, the petitioners seek to increase their protection by asserting that 1) each of the Participants is a "customer" under SIPA; 2) the claims of the petitioners should be allowed as ones for securities and not cash; and 3) in any event, the petitioners' losses resulted from the fraud of the broker and those losses therefore, should be protected by the Securities Investor Protection Corporation ("SIPC"). Thus, the issues presented are

I. In view of the fact that the intent of SIPA is to protect the "customer" as market investor or trader, whether a beneficiary of a trust is a "customer," for

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* For convenience, references herein to provisions of SIPA shall omit "15 U.S.C."

purposes of SIPA protection, where 1) the beneficiary does not have an account with the debtor brokerage firm, the account having been established only in the name of the trust; 2) the broker does not know the identity of the beneficiary; 3) the beneficiary receives no account statements from the broker or its clearing firm; and 4) the beneficiary has no authority to make trading decisions, all such decisions being made solely by the trust.

II. Whether a customer has a claim for "securities" under SIPA if the securities allegedly bought by the claimant are fictitious.

III. In view of the fact that SIPA protects customers only as to losses arising directly out of the financial failure of the broker by returning to them the cash and securities owed to them on the "filing date" (generally the date on which SIPC files the application to have the firm placed in liquidation), whether investors whose claims are for damages preceding the filing date and resulting from the broker's fraud are eligible for SIPA protection.

LIST OF PARTIES

The parties to the proceeding before the United States Court of Appeals for the Sixth Circuit were as follows:

1. The 490 Fund;

2. International Brotherhood of Electrical Workers Local 540 Pension Fund;

3. The Individual Participants in the 490 Fund;

4. The Individual Participants in the International Brotherhood of Electrical Workers Local 540 Pension Fund;

5. David and Violet Stansberry;

6. William Appleton, Trustee for the Liquidation of First Ohio Securities Co.; and

7. SIPC.

Although the International Union of Bricklayers and Allied Craftsmen, Health & Welfare Fund Local 55, was a party to the proceeding before the Bankruptcy Court, it did not appeal from the order of that court.

Only the 490 Fund and its individual participants seek review from the order of the Court of Appeals.

SIPC was created pursuant to a federal statute, and has no parent companies or subsidiaries.**

** SIPC's participation in this matter has been pursuant to SIPA section 78eee(d). In pertinent part, under that provision, SIPC is a party in interest as to all matters arising in a SIPA liquidation proceeding, "with the right to be heard on all such matters."

STATUTORY PROVISIONS

There is no issue in this case involving an interpretation of SIPA section 78fff(c). See Petition for Writ of Certiorari ("Cert. Pet.") at 2. That provision relates to customer transactions occurring after the "filing date." The "filing date" generally is the date on which SIPC files the application in district court to have the broker-dealer placed in SIPA liquidation, but also may mean the date on which a receiver, trustee, or liquidator, is appointed for a broker in a suit preceding the commencement of the SIPA case against it. SIPA §78lll(7). The latter circumstance is not present, and section 78fff(c) is erroneously cited by the petitioners as a provision involved in this case.

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Respondents.

BRIEF OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

COUNTERSTATEMENT OF THE CASE

This contested matter arises in the context of the liquidation proceeding under SIPA of FOSC, formerly a securities brokerage firm. Having given notice of the commencement of the proceeding and mailed copies of the notice and claim materials to customers and other creditors of the Debtor, the Trustee for FOSC received claims asserting "customer" status from, among others, the 490 Fund and its beneficiaries, the Individual Participants. The Fund claimed approximately $1.3 million in securities and $103,000 in cash.

The Participants sought cash balances amounting to their individual shares of the sums owed to the Fund. Following analysis and research of the claims, the Trustee denied those of the Participants because the latter were not "customers" under SIPA. The claim of the 490 Fund was allowed as a "customer" claim. However, because the Fund had invested in "securities" that did not exist, its entire claim was determined to be one for cash. Pursuant to SIPA section 78fff-3(a)(1), the Fund received in partial satisfaction of the amount owed to it, $100,000 advanced by SIPC.[1]

The petitioners objected to the determinations,[2] seeking to avail themselves of more protection from SIPC by arguing that 1) the Participants were "customers" and therefore, each was entitled to protection; 2) the Trustee had erred in determining the claim of the 490 Fund to be for cash and not securities; and 3) SIPA protects claims for damages that result from fraud. The same arguments were considered by each of the three lower courts. Each argument was rejected by each court.[3]

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[1] In addition to the SIPC advance, the 490 Fund is entitled to receive its *pro rata* share of the fund of customer property and of the general estate, if any. SIPA §78fff-2(c)(1).

[2] The filing of the objections created a contested matter under Bankruptcy Rule 9014. See Advisory Committee Note to Rule 9014 ("filing of an objection to a proof of claim ... creates a dispute which is a contested matter.")

[3] Because the 490 Fund misapprehends the manner in which claims for securities are satisfied under SIPA, it asserts that the protection would have been greater if its claim had been allowed as one for securities. Cert. Pet. at 15. In fact, it would have been much less. If a security claimed is not among the Debtor's assets, the Trustee purchases it for the customer if the security can be bought in a fair and orderly market. If not, the customer receives the filing date market value of the security, which in this case is the value on the date SIPC filed the application to have FOSC placed in liquidation. SIPA §§78fff-2(b) and (d) and 78*lll*(7). Had the claim of the 490 Fund been allowed as one for securities, the petitioner would have received nothing. The CDs in

SUMMARY OF THE ARGUMENT

The Court should deny the petition for a writ of certiorari for the following reasons:

1. In viewing the 490 Fund and not the Participants as the "customer" under SIPA, the decision of the Sixth Circuit is in accord with the applicable law on the question, that is, *SIPC v. Morgan Kennedy*, 533 F.2d 1314 (2d Cir.), *cert. den. sub nom., Trustees of Reading Body Works, Inc. v. SIPC*, 426 U.S. 936 (1976) ("*Morgan Kennedy*"), and SIPC Rule 104, 17 C.F.R. §300.104 ("Rule 104"). As reflected in *Morgan Kennedy* and Rule 104, the intent of SIPA is to protect the market participant as investor or trader, and not third party beneficiaries who stand to profit from such trading. Instilling confidence in the safety of his investments in the person who does the actual trading, promotes stability in the marketplace. In the case at hand, the market participant was the trust, that is, the 490 Fund, and not its individual beneficiaries. The account at the broker was in the name of the trust. Only it could make trading decisions. And it alone received account statements from the broker or its clearing firm.

In that regard, that the Participants are not "customers" is apparent from a review of the customer definition itself. Having no account at the broker, the Participants would not have a claim on account of securities received, acquired or held by the broker "for the securities accounts of such person." SIPA §78*lll*(2). Moreover, inasmuch as the monies were deposited with the broker by the Fund itself, and not the Participants, the latter could not be "customers" by reason of having "deposited cash with the debtor." *Id.*

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this case were fictitious and therefore could not have been bought for the Fund. Moreover, the filing date value of a nonexistent "security" must be zero. Instead of nothing, the Fund received $100,000 from SIPC.

2. There also is no conflict among the Circuits on the issue of whether the claim was for cash or for securities. The claim of the 490 Fund correctly was determined to be for cash. The Fund's cash was on deposit with the Debtor for the purpose of buying CDs which are securities under SIPA. Hence, the Fund was a "customer" under SIPA section 78*lll*(2), eligible for some form of protection. The extent of protection depended on whether cash or securities were being held for it on the "filing date." SIPA §§78fff-2(c) and 78*lll*(11). See *supra*, n.3. If, as in the case at hand, a security never existed, there can be none for the customer to claim. In that circumstance, the claim is not for a "security," but for the return of the cash that the customer tendered to the broker for the purchase.

The fact that the CDs were fictitious was uncontested at trial, and in any event, would present no issue worthy of review by this Court. *United States v. Johnson*, 268 U.S. 220, 227 (1925) (court does "not grant a certiorari to review evidence and discuss specific facts"). The cases relied upon by the petitioners did not involve fictitious securities, and have no bearing on this case.

3. Provisions of SIPA and a long line of cases construing it establish that a principal goal of the statute is to protect customers against the consequences of the financial failure of broker-dealers, and not to protect them from a broker's fraud. Here too, the cases relied upon by the petitioners are inapposite and create no conflict with the decision at hand.

4. Petitioners raise no important question warranting review. The issues are significant only to the parties involved, and have no importance beyond the narrow confines of SIPA cases.

ARGUMENT

The instant contested matter was brought within the context of a SIPA proceeding. Because an understanding of the

nature of the proceeding is significant to a proper resolution of the petition, the history of SIPA, as well as its purposes and relevant provisions, are examined below.

Nature of a SIPA Proceeding: Its History and Purposes

Prior to 1938, customers of a bankrupt stockbroker were considered as general creditors if they could not reclaim cash or securities which they could trace into the broker's possession. *Duel v. Hollins*, 241 U.S. 523, 527-29 (1916). Because serious inequities could and did result from this method of reclaiming, Congress enacted section 60(e) of the Bankruptcy Act in 1938.

A. Section 60(e) of the Bankruptcy Act

Section 60(e) of the former Bankruptcy Act, 11 U.S.C. §96(e) (repealed 1979), permitted "cash customers," as defined therein, to reclaim fully paid securities which were "specifically identifiable" as their property. 11 U.S.C. §96(e)(4) (repealed 1979). Otherwise, customers' cash and securities (not "specifically identifiable") constituted a "single and separate fund" to be applied in satisfaction of customers' claims (other than for specifically identifiable property) on a *pro rata* basis, subject only to prior payment of certain administrative expenses. 11 U.S.C. §96(e)(2) (repealed 1979). As for the unpaid balance of their "net equities", customers shared with general creditors in the general estate. See 3 *Collier on Bankruptcy*, ¶¶60.71-60.76 (14th ed. 1977).

Because of the usually inadequate single and separate fund, section 60(e) did not prevent customer losses. Customer exposure mounted when the rate of stockbroker failures accelerated in the 1960s. Congress responded to the crisis by enacting SIPA. *SIPC v. Barbour*, 421 U.S. 412, 415 (1975).

B. SIPA and SIPA as Amended

With some adjustments, SIPA expressly continued the

substantive scheme of section 60(e). Customers were still entitled to the return of their "specifically identifiable property." §78fff(c)(2)(C) (1970). SIPA also continued the single and separate fund to satisfy net equity claims of customers. §78fff(c)(2)(A) and (B) (1970). The major impact of SIPA on customer recoveries was to reduce losses by providing a limited back-up through SIPC funds. In essence, SIPA improved "collectability" while adhering to the section 60(e) philosophy of according customers limited preferential rights based on their actual securities and cash positions entrusted to the broker.

In 1978, SIPA was amended to provide greater flexibility to SIPC in satisfying customer claims in an expeditious fashion.[4] The essential elements of a SIPA proceeding remained unchanged.

C. SIPC and Its Funds

SIPC is a non-profit corporation whose members include most interstate broker-dealers. Membership in SIPC is automatic upon registration as a broker or dealer with the Securities and Exchange Commission ("SEC") under 15 U.S.C. section 78o(b). SIPA §78ccc(a)(2)(A).

SIPA requires SIPC to establish a fund via assessments upon its members. §78ddd(a)(1). If SIPC's funds should become inadequate, SIPA authorizes a borrowing against the U.S. Treasury of up to one billion dollars. §78ddd(f) - (h). These resources are available for the satisfaction of customer claims within certain limits.

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[4] SIPA has been amended by Pub. L. No. 94-29, 89 Stat. 163 (1975); Pub. L. No. 95-283, 92 Stat. 249 (1978); Pub. L. No. 95-598, 92 Stat. 2674 (1978); Pub. L. No. 96-433, 94 Stat. 1855 (1980); Pub. L. No. 97-258, 96 Stat. 1067 (1982); Pub. L. No. 97-303, 96 Stat. 1410 (1982); and Pub. L. No. 100-181, 101 Stat. 1265 (1987).

D. Use of SIPC Funds to Satisfy Customer Claims

SIPA requires the distribution of "a quasi-public fund." *SEC v. Packer, Wilbur & Co.*, 498 F.2d 978, 980 (2d Cir. 1974). Under section 78fff-3(a), SIPC is authorized to advance to the trustee, in order to satisfy net equity claims of customers, up to $500,000 per customer of which no more than $100,000 may be used to satisfy a claim which is for cash rather than for securities. Regardless of the assets of the failed firm, each customer eligible for protection is assured of satisfaction within the SIPA limits. However, SIPA does not attempt to make all customers whole and SIPC's role is carefully delineated. It contemplates that customers' claims will be satisfied to the maximum extent possible from the assets of the defunct member firm. Thus, customers share on a *pro rata* basis in any fund of customer property and any general estate, §78fff-2(c)(1), with SIPC funds supplementing those assets within the limits and in the manner provided by the statute. To the extent of its advances, SIPC is subrogated to the claims of such customers. SIPA §78fff-3(a). *See SIPC v. Associated Underwriters, Inc.*, 423 F.Supp. 168, 170-173 (D. Utah 1975).

E. Bankruptcy Nature of a SIPA Proceeding

Notwithstanding the special protection afforded customers, a proceeding under SIPA essentially is a bankruptcy liquidation. See, *e.g., SIPC v. Ambassador Church Finance/Development Group, Inc.*, 788 F.2d 1208, 1210 (6th Cir.), *cert. den. sub nom., Pine Street Baptist Church v. SIPC*, 479 U.S. 850 (1986); *SEC v. Albert & Maguire Sec. Co.*, 560 F.2d 569, 572 (3d Cir. 1977); *Exchange National Bank v. Wyatt*, 517 F.2d 453, 457-459 (2d Cir. 1975); *SEC v. Aberdeen Securities Co.*, 480 F.2d 1121, 1123 (3d Cir.), *cert. den. sub nom., Seligsohn v. SEC*, 414 U.S. 1111 (1973). Indeed, one of the stated goals of the proceeding is "to liquidate the business of the debtor." SIPA §78fff(a)(4). The application to commence a proceeding is filed by SIPC in federal district court, §78eee(a)(3), which puts into effect the Bankruptcy Code's automatic stay.

11 U.S.C. §362(a). If the court grants the application, it appoints a trustee to administer the liquidation and removes the proceeding to the bankruptcy court for that district. §§78eee(b)(3) and (b)(4). To the extent consistent with SIPA, the SIPA proceeding is to "be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7" of the Bankruptcy Code. §78fff(b).

Because the SIPA proceeding effectively is a bankruptcy proceeding, it looks not only to the disposition of claims of customers, but also to the claims of general creditors. *In the Matter of Lewellyn*, 26 B.R. 246, 253 (Bankr. S.D. Iowa 1982); *Gold v. Hyman*, [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,043 at p. 97,657 (S.D.N.Y. 1975). To enable the trustee to carry out his responsibilities not only to customers but to the entire bankruptcy estate and all of its creditors, the trustee is given the same powers and title with respect to the debtor and its property as a trustee in bankruptcy, as well as powers that will enable him to perform the special functions of a SIPA liquidation. §78fff-1(a). *See SIPC v. Christian-Paine & Co.*, 755 F.2d 359, 361 (3d Cir. 1985). Estate property collected by the trustee is distributed as specified in section 726 of the Bankruptcy Code. §78fff(e).

A SIPA proceeding has elements that differ from those of a bankruptcy proceeding. For example, in the SIPA liquidation, the trustees and their counsel, while appointed by the district courts, are selected by SIPC. §78eee(b)(3). The trustee is responsible for mailing notices to customers and other creditors. §78fff-2(a)(1). Customers "need not file a formal proof of claim" but must file a "written statement of claim," which is submitted to the trustee instead of the court. §78fff-2(a)(2).

F. The Burden of Proof

"Customer" status in a SIPA proceeding is a preferred status which gives the customers priority over other creditors in

the distribution of certain assets marshalled by the trustee. *SIPC v. I.E.S. Management*, 612 F.Supp. 1172, 1177 (D.N.J. 1985), *affirmed w/o opinion*, 791 F.2d 921 (3d Cir. 1986) ("customers" under SIPA receive preferential treatment by being satisfied ahead of general creditors); *In re Hanover Square Securities*, 55 B.R. 235, 237 (Bankr. S.D.N.Y. 1985) ("[a]ffording customer status confers preferential treatment"); *In re Government Securities Corp.*, 90 B.R. 539, 540 (Bankr. S.D. Fla. 1988) ("customers" under SIPA have "preferred status"). SIPA derives from subsection "e" of section 60 of the Bankruptcy Act (repealed 1979) which was entitled "Preferred Creditors." Because of the availability of SIPC funds, one who qualifies as a customer in a SIPA proceeding may be paid, within the limits of protection, even when the debtor's estate has no assets. §§78fff-2(b)(1) and 78fff-3(a).

In ordinary bankruptcy, claimants seeking a preferred status bear the burden of showing that they are within the class of eligible persons and that their transactions are protected under the Act. *In re Chitwood*, 3 Bankr. Ct. Dec. 1033, 1034 (Bankr. S.D. Ala. 1977). *Accord, In re O.P.M. Leasing Services, Inc.*, 60 B.R. 679, 680 (Bankr. S.D.N.Y. 1986). The same rule applies to a SIPA case. In a SIPA proceeding, the burden of proof rests with the party seeking customer status. See §78fff-2(b). See also *In re Brentwood Securities, Inc.*, 925 F.2d 325, 328 (9th Cir. 1991); *In re Oberweis Securities, Inc.*, [1992 Decisions] Fed. Sec. L. Rep. Transfer Binder (CCH) ¶96,890 at 93,650 -- 93,651 (Bankr. N.D. Ill. 1992); *In re Waddell Jenmar Securities, Inc.*, 126 B.R. 935, 942 (Bankr. E.D.N.C. 1991).

I. THE SIXTH CIRCUIT'S CONCLUSION THAT THE TRUST, AND NOT THE INDIVIDUAL PARTICIPANTS, IS THE "CUSTOMER," IS CONSISTENT WITH THE RELEVANT LAW.

A. *Morgan Kennedy*

The conclusion of the Sixth Circuit that the Individual

Participants were not "customers" comports fully with the applicable law, *Morgan, Kennedy* and SIPC Rule 104. In *Morgan Kennedy*, the Second Circuit considered whether employee-beneficiaries of a trust created under a profit-sharing plan were "customers" under SIPA. Noting that the emphasis in the legislative history of, and case law under, SIPA was on protection of customers as investors and purchaser/traders, the court concluded that the trust beneficiaries could not qualify as customers. 533 F.2d at 1317. Thus, the trust funds had been contributed by the employer; the trustees of the trust made the decision to entrust the funds to the debtor in that case; the beneficiaries were not traders or investors; the employees' interest was reflected only on the books of the pension plan, and not on those of the broker; the trust account was in the name of the trustees on the broker's records; no beneficiary could give buy or sell orders in the account; and the trustees had the exclusive power to remit funds to the broker, to invest, and to make trading decisions. Furthermore, none of the usual characteristics of a broker-customer relationship existed between the broker and the trust beneficiaries. *Id.* at 1318. In the court's view, the customer on whose behalf the broker acted was the trust itself. *Id.* at 1321.

The facts with respect to the 490 Fund are virtually identical to those in *Morgan Kennedy*. Uncontroverted evidence adduced at trial, including, in part, the trust agreement, established that 1) the trust funds invested with FOSC were contributed by the Employer; 2) title to the trust funds was solely in the trustees; and 3) the trustees had exclusive authority and discretion to manage and control fund assets. The Fund alone dealt with the broker and was the market participant. Thus, as Robert Frazier, the principal officer of the Fund's administrator as well as a consultant and attorney to the Fund, testified, the 490 Fund brokerage account was in its name. Only one account had been created. The individuals never received account statements from FOSC or its clearing broker. Indeed, they could not have, as their identities would not have been known to the broker. The 490 Fund alone could make trading

decisions. Individual participants had no such authority.[5]

The Fund's attempt to distinguish this case from *Morgan Kennedy* on the ground that it is a defined contribution plan is to no avail. Cert. Pet. at 17-21. Although the books of the 490 Fund ostensibly identified the Individual Participants' interests in Fund assets, *id.* at 18, the books of the broker-dealer did not. As far as the broker-dealer was concerned, the only investor-trader was the Fund. The participants, all of whom were unidentified to the broker, were mere beneficiaries who stood to profit or lose from the Fund's, and not their own, market involvement. The *Morgan Kennedy* decision continues to be the correct interpretation of SIPA, see 4 *Collier on Bankruptcy*, ¶745.02 at p. 745-4 (15th ed. 1994), and was fully applicable here.[6]

In re Waddell Jenmar Securities, Inc., 126 B.R. 935 (Bankr. E.D.N.C. 1991) ("*Waddell*"), relied upon by the petitioners, compels no different conclusion. As an initial matter, it should be noted that no appeal was taken from the bankruptcy court decision in *Waddell*. Therefore, the Fund's citation (Cert. Pet. at 19-20) showing affirmance by the Fourth Circuit is in error, and there is no conflict between circuit court decisions.[7] Furthermore, *Waddell* neither supports the

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[5] These circumstances alone point up the fact that the participants are not "customers" under SIPA section 78*lll*(2). Having established no account with, and purchased no securities through, the Debtor, the participants could have no "claim on account of securities received, acquired, or held by the debtor.... from or for the securities accounts of such person." SIPA §78*lll*(2). Moreover, because all monies came from the trust, the participants could not be customers by reason of having deposited cash with the Debtor. *Id.* See Cert. Pet. at 13.

[6] As recognized in *Morgan Kennedy* and in SIPC Rule 104, discussed below, trust beneficiaries receive no protection as customers. 533 F.2d at 1319-1320.

[7] 991 F.2d 792 (4th Cir. 1993) reflects the Fourth Circuit's affirmance of a district court decision in another proceeding within the *Waddell* case. That adversary proceeding involved litigation over a fidelity bond between SIPC as trustee and the insurer, the National Union Fire Insurance Co. of Pittsburgh, PA. *In re Waddell*

petitioners' position nor conflicts with *Morgan Kennedy*. Cert. Pet. at 20. In *Waddell*, the bankruptcy court concluded that certain trust fund participants were not "customers" because their monies, having been misappropriated, never were deposited with the broker so as to render the participants customers. In reaching that conclusion, the court opined that the participants were customers as to some transactions; however, those transactions were not the subject of the claims that had been filed. Although the court's pronouncement would appear to support the petitioners' position, in fact, it does not for at least several reasons. First, the statement is mere dictum having no bearing on the court's holding. Second, that the court elected not to decide the same issue as the one presented here, is clear from its discussion at a later point in the decision. There, it remarked:

> SIPC had argued that the [participants] were limited to one aggregate claim rather than each having individual claims. The issue would only be relevant if the aggregate allowed claims exceeded the SIPC claim limit. That is not the case here, and that issue need not be addressed.

126 B.R. at 944, n.9. Finally, even assuming, *arguendo*, that *Waddell* had decided that trust participants could be "customers," the facts of the case are sufficiently distinguishable as to make it inapplicable. Thus, in *Waddell*, each employee would direct the investment of his portion of the plan fund. Each would receive a personal account summary from Guilford Waddell who was president both of the debtor broker-dealer and of the administrator of the plan. Each would meet with him to discuss investment strategy and each would give him investment instructions. In contrast, no evidence was introduced below showing direct trading by the participants in this case.

Jenmar Securities, Inc. (SIPC v. National Union Fire Ins. of Pittsburgh, PA), 25 Fed. Rules Serv. 3d 713 (4th Cir. 1993).

B. SIPC Rule 104

The fact that the Sixth Circuit's decision is consistent with applicable law is borne out not only by *Morgan Kennedy*, but by SIPC Rule 104(b), 17 C.F.R. §300.104(b). Under SIPA section 78fff-3(a), within specified limits, SIPC advances funds "for each customer." However, a customer holding accounts in different capacities is "deemed to be a different customer in each capacity." §78fff-3(a)(2). The Series 100 Rules define when accounts are held in separate capacities. Rule 104(b) thereof provides as follows:

> A qualifying trust account held with a member shall be deemed held by a separate customer of the member, distinct from the trustee, the testator or his estate, the settlor, or any beneficiary of the trust.

Thus, under SIPC rule 104(b), which is law,[8] as under the Sixth Circuit's decision, the trust alone is the customer.

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[8] The Series 100 Rules were adopted by SIPC pursuant to SIPA section 78ccc(b)(4). Once approved by the SEC, SIPC rules are to "be given force and effect as if promulgated by the Commission." SIPA §78ccc(e)(2)(D). See also SIPA §78ccc(e)(2)(A). Inasmuch as Congress has delegated to SIPC the power to adopt rules defining terms used in SIPA, the Series 100 Rules are legislative in nature and have the full force and effect of law. As stated in the legislative history of SIPA section 78ccc:

> New procedures appropriate to legislative, rather than interpretive rules are provided since SIPC's rules will have the force and effect of law.

H. R. Rep. No. 746, 95th Cong., 1st Sess. 25 (1977). See *Chrysler Corp. v. Brown*, 441 U.S. 281, 301-303 (1979); *United States v. Mersky*, 361 U.S. 431, 437-438 (1960); *Baker v. Otis Elevator Co.*, 609 F.2d 686, 691 (3d Cir. 1979) ("[v]alid legislative rules have about the same effect as valid statutes; they are binding on courts").

II. THE DECISION THAT THE CLAIM WAS FOR CASH, AND NOT SECURITIES, IS CONSISTENT WITH THE RELEVANT LAW.

A. The Applicable Case Law

The 490 Fund also errs in contending that the decision that its claim was for cash conflicts with applicable law. To be sure, the deposit of the Fund's cash with the broker for the purpose of purchasing CDs, which are securities under SIPA section 78*lll*(14), made it a customer under the statute, but it does not mean that, as a customer, the Fund was owed CDs. Under SIPA section 78*lll*(2), "customer" includes "any person who has deposited cash with the debtor for the purpose of purchasing securities." However, the mere deposit of cash in order to buy securities does not make the purchase an accomplished fact. Rather, in order to determine whether the customer is owed cash or securities, it is necessary to examine the customer's transactions, as shown on the debtor's books and records or as "otherwise established to the satisfaction of the trustee." SIPA §78fff-2(b). Furthermore, because claims are measured under SIPA as of the "filing date," *id.* and SIPA §78*lll*(7) and 78*lll*(11), what is owed to the customer must be computed as of that date. See *In re Bell & Beckwith (Murry v. McGraw)*, 821 F.2d 333, 335 (6th Cir. 1987); *SEC v. Aberdeen Securities Co.*, 480 F.2d 1121, 1123-24 (3d Cir.), *cert. den. sub nom., Seligsohn v. SEC*, 414 U.S. 1111 (1973); *Matter of Bevill, Bresler & Schulman, Inc.*, 83 B.R. 880, 892 (D.N.J. 1988).

Beyond dispute, the CDs did not exist. The Fund offered no proof that any had been bought. Indeed, it could not have because, as the Trustee's investigation revealed, the Fund's money, like that of other customers, had not been used to buy securities for customers, but had been converted by Thomas Gilmartin, a principal of the Debtor, to his own use. In light of the evidence, the Sixth Circuit correctly concluded that the Fund had a claim for cash, a result clearly consistent with the

pertinent case law as discussed below.

In *SEC v. Aberdeen Securities Co., supra*, the claimant had purchased shares of a prospective new issue. The shares were paid for, and the trade confirmed to the claimant by its broker, Aberdeen Securities Co. ("Aberdeen"). Although Aberdeen remitted the funds to the broker-dealer underwriting the offer, no certificates were received. Instead, before the stock could be issued, both the issuer and the underwriter went into bankruptcy. A SIPA liquidation proceeding subsequently was initiated for Aberdeen, and the claimant filed a claim in that proceeding. Because the security had no value, the Aberdeen trustee determined that no payment could be made to the claimant, a conclusion that was affirmed by the lower court. On appeal, the Third Circuit disagreed, commenting as follows:

> *[T]he facts demonstrate that since this particular stock was not in existence, the purchase never could be made. The Raizes, therefore, do not have a claim for the stock itself.*
>
> * * *
>
> Thus, if under local law, or by virtue of regulations under which it operated, the debtor was obligated to refund the $500 to the Raizes because of inability to deliver the Boatland stock, then there would be a claim for cash properly included in the term "net equity." [Emphasis added].

480 F.2d at 1127. Similarly, in *In re Brentwood Securities, Inc.*, 925 F.2d 325, 328, 329 (9th Cir. 1991), the court concluded that the debtor broker-dealer did not hold shares of a security for a claimant where the shares had not come into existence.

B. The Series 500 Rules

Contrary to the petitioners' contention, the SIPC Series 500

Rules, 17 C.F.R. §300.500 *et seq.*,[9] create no conflict. Although the 490 Fund contends that it introduced evidence establishing the existence of securities, in fact, the only proof offered suggested that the Fund might have *believed* at one time that CDs existed. Relying upon the Series 500 Rules, the petitioners maintain that because they expected the broker to be holding securities for them, their claim must be for securities. The Series 500 Rules do not apply, and in any event, any expectation by the Fund that CDs had been bought for it was unfounded.

The Series 500 Rules relate to whether a customer has a claim for cash or for securities; however, they have no bearing on the situation where a security does not exist. The circumstance intended to be reached by the Rules is illustrated by a number of cases, the most recent of which, before the adoption of the Rules, was *In re Bell & Beckwith (Murray v. McGraw)*, 821 F.2d 333 (6th Cir. 1987) ("*Murray*"). See 53 Fed. Reg. at 10368, n. 1 (Mar. 31, 1988). On February 4, 1983, the Murrays instructed their broker to sell certain stock. The sale was effectuated and a statement confirming the sale was issued to them. The statement showed a "trade date" of February 4, but a "settlement date" of February 11.[10] One day after the trade date, and before the settlement date, the broker failed. The Murrays argued that notwithstanding the sale, their claim was for securities. In the intervening period between the placement of the firm in SIPA liquidation and the filing of the Murrays' claim, the stock had become more valuable. *Murray*,

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[9] The petitioners mistakenly refer to the SIPC Series 500 Rules, as rules of the SEC. Cert. Pet. at 21, 23. Although proposed SIPC rules are subject to approval by the SEC, and are given force and effect as though promulgated by the SEC, they nevertheless are promulgated by SIPC. SIPA §78ccc(e)(2).

[10] The trade date is the date on which a trade occurs. The settlement date is the date cash and securities actually change hands. New York Institute of Finance, *Introduction to Brokerage Operations Dept. Procedures* (2d ed. 1988) at 229, 233.

821 F.2d at 334-335. The court held the claim to be for cash. *Id.* at 339-340.

The issue presented in *Murray* is typical of the situation intended to be reached by the Series 500 Rules, and indeed triggered the adoption of the rules. 53 Fed. Reg. at 10368, n.1. A review of the other cases giving rise to the Rules reveals that in no instance was the security at issue fictitious. *Id.* To be sure, Rule 502(a)(1), 17 C.F.R. §300.502(a)(1), specifies that a customer has a securities claim where, as in *Murray*, the customer has been sent "written confirmation ... that the securities in question have been purchased for or sold to the customer's account." Although in the instant case, documents which purported to be confirmations were sent to the 490 Fund, not only were the statements fictitious but more importantly, there never were any "securities" to purchase. Hence, clearly, the Series 500 Rules cannot apply.

In re June S. Jones Co., 52 B.R. 810 (Bankr. D. Ore. 1985) ("*Jones*"), cited by the petitioners, does not suggest otherwise. Cert. Pet. at 24-25. The MSM stock in that case was an actual security. Furthermore, it is noteworthy that in *Jones*, the bankruptcy court observed that the *Aberdeen* case, discussed above, was distinguishable factually in that it involved, unlike *Jones*, a situation where the security could not have been purchased because it did not exist. 52 B.R. at 813. In view of the Series 500 Rules which provide, in relevant part, that a customer has a claim for a security if he has received written confirmation of a purchase, the *Jones* court correctly concluded that a customer may be owed securities even if the securities were not purchased prior to the filing date. 52 B.R. at 813. However, contrary to the petitioners' contention, as recognized in *Jones* in distinguishing *Aberdeen*, that rule does not apply where the security does not exist.[11]

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[11] Similarly, *In re C. J. Wright & Co.*, 162 B.R. 597 (Bankr. M. D. Fla. 1993), an unauthorized trading case, is inapplicable. Cert. Pet. at 27.

C. The Account Statements

In any event, reliance by the Fund upon the confirmations would have been unreasonable inasmuch as a critical piece of information was missing from them. A CD evidences an obligation of a bank or savings association to repay the principal amount of the certificate, with interest, at maturity. Allan H. Pessin, *The Illustrated Encyclopedia of the Securities Industry* 62 (1988). The physical certificate that is issued contains the names of the issuing bank or savings association and the purchaser, the principal amount deposited with the financial institution, the rate of interest payable at maturity, and the term of the CD. See Marcia Stigum, *The Money Market* 526 (1983). The putative confirmation statements issued to the 490 Fund confirmed the purchases of CDs, yet, nowhere in the statements was the name of the issuing bank or savings association revealed. Absent identification of the issuer, the Trustee would not know which CDs to attempt to purchase on the open market for delivery to the claimants. Nor could he ascertain a filing date market value in the event the security was not available in a fair and orderly market. See *supra*, n.3 and SIPA §78fff-2(b). Yet, a factor that is crucial to the market value of a CD is the financial condition of the issuer. See Marcia Stigum, *The Money Market* 36 (1983) ("Yields on CDs exceed those on bills of similar maturities by varying spreads. One reason for the higher yield is that buying a bank CD exposes the investor to some credit risk -- would he be paid off if the issuing bank failed?"). If the issuer fails financially, its CDs ostensibly have a value of zero. To ascribe any other value to the instant fictitious CDs, one has to assume that the issuer is a publicly or privately insured institution, that the CDs are covered by the insurance, and that the insurance fund itself is or was solvent.

It bears mention that it is perhaps not surprising that the Fund failed to question the completeness and accuracy of the statements. Testimony elicited at trial established that Mr. Frazier, as a principal officer of the 490 Fund's administrator

with oversight of the Fund's investments, and as a consultant to it, was engaged in various business endeavors of his own with Mr. Gilmartin, the FOSC principal, which undoubtedly colored his objectivity in overseeing the Fund's investments. Not until a new administrator was retained by the 490 Fund were irregularities in the statements questioned. Cert. Pet. at 13. The Sixth Circuit's decision comports with applicable law.

III. THE SIXTH CIRCUIT'S DECISION FOLLOWS WELL-ESTABLISHED LAW THAT SIPA DOES NOT PROTECT INVESTORS AGAINST THEIR BROKER'S FRAUD.

Petitioners' contention that SIPA protects against damages that result from a broker's fraud overlooks the nature of the SIPA protection and a long line of cases that recognize that no such protection is afforded under the Act.

Preliminarily, the petitioners mistakenly argue that the Court of Appeals denied them the protection afforded to customers with "securities" claims because of their broker's fraud. Cert. Pet. at 26. In actuality, that the 490 Fund was misled was irrelevant to the determination of its claim. Rather, the claim of the Fund was allowed in full, but it was allowed as a "cash" claim because no purchase of genuine securities was confirmed to them or made for them.

Nonetheless, the petitioners assert that it comports with the purposes of SIPA for customers to be protected for their damages resulting from the broker's fraud. Cert. Pet. at 26-29. In fact, it does not. Although a central goal of SIPA is investor protection, the protection is a carefully crafted and limited one. As evident from the language of the "customer" definition (SIPA §78*lll*(2)), the intent of Congress was to protect persons who had entrusted cash or securities to their brokers for the

purposes of trading and investing.[12] Protecting customers' cash and securities and thereby instilling confidence in the securities markets was perceived as essential to protection of the markets. *Hearings on H. R. 13308 Before the House Subcomm. on Commerce and Finance of the Comm. on Interstate and Foreign Commerce*, 91st Cong., 2d Sess. ("1970 H. Hearings") at 149-150 (June 4, 1970) (statement of Mr. Budge). *See also id.* at 345 (July 9, 1970) (statement of Bruce K. MacLaury, Deputy Undersecretary of the Treasury Dept.); and *Hearings on S. 2348 Before the Senate Subcomm. on Securities of the Comm. on Banking and Currency*, 91st Cong., 2d Sess. ("1970 S. Hearings") at 4 (April 16, 1970) (testimony of Sen. Muskie). At the same time, it was emphasized that the protection under SIPA had to be limited. A SIPA proceeding could not be turned into a "bailout operation." 1970 H. Hearings at 369 (July 15, 1970) (statement of Mr. Budge). *See* 1970 S. Hearings at 16 (April 16, 1970) (remarks of Mr. Budge), and 279 (July 16, 1970) (remarks of Philip A. Loomis, General Counsel of the SEC).

In furtherance of the notion that the proceeding is not a "bailout operation" in the sense of satisfying every investor loss, the asserted loss must be a direct result of the broker's insolvency, in order to be covered under SIPA. Thus, under SIPA section 78*lll*(11), a customer's "net equity," or the measure of what he is owed in cash and/or securities, is valued as of the filing date. The statute thereby emphasizes that the legislative intent is to maintain the *status quo* of matters generally as they stand on the date SIPC seeks to have the firm placed in liquidation. SIPA §78*lll*(7).

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[12] *SIPC v. Executive Securities Corp.*, 556 F.2d 98, 99 (2d Cir. 1977); *SEC v. F.O. Baroff Co.*, 497 F.2d 280, 282-283 (2d Cir. 1974); *SIPC v. Associated Underwriters, Inc.*, 423 F.Supp. 168, 171 (D. Utah 1975).

The case law consistently has reflected that intent.[13] As stated in *In re, MV Securities, Inc.*, 48 B.R. 156, 160 (Bankr. S.D.N.Y. 1985):

> The cases hold that the "SIPA does not protect customer claims based on fraud or breach of contract." *SEC v. Howard Lawrence & Co., Inc.*, 1 B.C.D. 577, 579 (Bkrtcy. S.D.N.Y. 1975). "[I]t seems plain that SIPA's primary intent and policy are to protect customers who have cash and securities being held for them by a broker dealer, *rather than to serve as a vehicle for the litigation of claims of fraud* or violations of Rule 10b-5****" *SEC v. North American Planning Corporation*, 72 Civ. 3158 (Bkrtcy. S.D.N.Y. 1974) (Unpublished Opinion at 4). "To require the Trustee to use SIPC funds to pay damages for a breach of contract claim against the debtor would not serve the congressional purpose of avoiding the domino effect inherent in unfulfilled open contractual commitments and would only serve to give a windfall to those who are general creditors based upon breach of contract claims." *SEC v. Kelly, Andrews & Bradley, Inc.*, 385 F.Supp. 948, 949, 952-3 (D.C. S.D.N.Y. 1974). Although the emphasis on the customer as investor and purchaser/trader has been a consistent theme in cases in the Second Circuit, the court has nevertheless approved a narrow interpretation of the "customer" definition in

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[13] *SIPC v. Vigman*, 803 F.2d 1513 (9th Cir. 1986), *appeal after remand*, 908 F.2d 1461 (9th Cir. 1990), *aff'd in part and rev'd in part*, ____ U.S. ____, 112 S. Ct. 1311 (1992), ("*Vigman*"), and *Matter of Investors Sec. Corp.*, 6 B.R. 420 (W.D. Pa. 1980), are no exceptions. See Cert. Pet. at 28. No customer status question was presented in *Vigman* which involved SIPC's standing to sue for securities fraud. Similarly, the decision is *Matter of Investors Sec. Corp.*, which was modified on appeal, *In the Matter of Investors Security Corp. (Ravis v. Day)*, Civil Action No. 80-1032 (W.D. Pa. 1981), presented the question of whether a salesman of a broker who also operated independently his own business constituted an agent of the broker so as to render the investor a "customer."

SIPA. [citations omitted and emphasis added].

See *SEC v. Kenneth Bove & Co.*, 378 F.Supp. 697, 700 (S.D.N.Y. 1974); *Matter of Oberweis Securities, Inc.*, 135 B.R. 842, 846 (Bankr. N. D. Ill. 1991); *In re Bell & Beckwith*, 124 B.R. 35, 36 (Bankr. N. D. Ohio 1990); *In re Government Securities Corp.*, 90 B.R. 539, 540-541 (Bankr. S. D. Fla. 1988); *Matter of M. S. Wien & Co.*, 54 B. R. 18, 19-20 (Bankr. D.N.J. 1985). The decision of the Sixth Circuit is in accord.

The petition presents no issue worthy of review. It identifies no conflict between court decisions and does not present the kind of important question justifying review. It is significant only to the parties involved, and has no implications other than in the narrow body of SIPA cases. In the final analysis, it is no more than an attempt to obtain protection where none exists. As the Ninth Circuit stated:

> Every market has its dreamers and its crooks. Occasionally, they are one and the same. The SIPA protects investors when a broker holding their assets becomes insolvent. It does not comprehensively protect investors from the risk that some deals will go bad or that some securities issuers will behave dishonestly.

In re Brentwood Securities, Inc., 925 F.2d 325, 330 (9th Cir. 1991).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

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